MAY 2011

Public pensions and other retirement issues stayed in the D.C. spotlight in May as a House of Representatives panel vetted a proposal from a California congressman that would impose reporting mandates on state and local retirement funds; members of the public pension community continued to work to rebut claims by pension critics; the Congressional Budget Office offered its take on a pivotal pension financing question; and the financial forecast for Social Security worsened.

ISSUES AND EVENTS

Lawmaker Criticizes Plan to Boost Pension Costs for Federal Workers

A Democratic lawmaker on May 18 criticized attempts to make federal workers contribute more to their pension plans.

Federal government workers contribute 0.8 percent of wages to their retirement plans, but the Obama administration and some members of Congress have embraced a recommendation of the National Commission on Fiscal Responsibility and Reform that the amount be increased. Republican congressmen are taking a more aggressive approach than the White House, seeking to boost the number to 6 percent to save $120 billion over the next decade.

"They are deliberately making the federal employee a scapegoat for the federal debt and deficit spending," Rep. Gerry Connolly, D-Va., said. If pension costs increase for federal workers, Connolly added, "People are going to look at that and wonder, is this really a career I want to choose? We're making it a far less attractive choice for people entering the workforce."

Connolly linked the move to restructure federal pensions with other GOP-led efforts to reduce public employee benefits.

"Given the behavior of prominent Republican politicians in Wisconsin, Ohio, Florida and in the Congress, we have every reason not to trust their motivation when they say, 'We're just looking for savings,'" Connolly said. "No, you're not. You're actually looking to break the back of the public workers, public employees and the organizations that represent them. That's really your agenda."

Critics of federal employee pensions note that, in the private sector, defined benefit pensions have become a rarity and workers pay more toward their retirement. Defenders, though, respond that public sector salaries tend to be lower, that government workers do not have benefits such as stock options and profit-sharing available to them, and that the defined contribution accounts that have replaced many traditional pensions force workers to assume a large amount of investment risk.

"These plans," Diane Oakley, executive director of the National Institute on Retirement Security, said of defined benefit pensions, "are always better because they're a stable guarantee of retirement income."

Social Security Financial Forecast Worsens

The Social Security trust funds are in worse shape than had been forecast in 2010, according to the annual report of the program's trustees.

The Old-Age and Survivors Insurance and Disability Insurance (OASDI) Trust Funds are now expected to run out of money in 2036, one year earlier than the previous projection. After this point, annual revenues will be able to pay only 77 percent of scheduled benefits.

"The current trustees report again reflects what we have long known to be true – we need changes to ensure the long-term solvency of Social Security and to restore younger workers' confidence in the program," Social Security Commissioner Michael Astrue said.

On a yearly basis, the program already spends more than it receives in tax revenues, with the difference now being covered by interest on trust fund assets. It will start drawing down money from the trust funds in 2023, according to the report.

Over 75 years, the Social Security shortfall is estimated to be $6.5 trillion, or 2.22 percent of payroll. The financial challenges largely result from the retirement of baby boomers. While there were 2.9 workers for every retiree in 2010, that number will decline to 2.1 by 2035, and will continue to decline after that because of increasing life expectancies.

"The projected trust fund shortfalls should be addressed in a timely way so that necessary changes can be phased in gradually and workers and beneficiaries can be given time to adjust to them," the report stated. "Implementing changes sooner would allow the needed revenue increases or benefit reductions to be spread over more generations."

The Social Security program had $713 billion in expenditures in 2010 and $781 billion in revenues, pushing the combined balance of the trust funds to $2.6 trillion.

GOP Guarding Against Recess Appointment of Warren

The Senate did not officially adjourn for a Memorial Day recess because Republicans wanted to ensure that President Obama did not have the opportunity to make the architect of the new Consumer Financial Protection Bureau the agency's director through a recess appointment.

Elizabeth Warren, the presidential advisor who is guiding the creation of the bureau, which was created by the 2010 financial regulations reform law to oversee mortgages, credit cards, student loans and other consumer financial products, is the favorite of many liberal activists to head the agency once it begins operations on July 21. Many Republicans, however, consider her to be an anti-business choice for an agency they already revile as anti-business. House Republicans have proposed several changes to the bureau, and 44 of the Senate's 47 Republicans wrote in a May 5 letter to Obama that they will oppose any director nominee unless the agency's structure is revised by, among other things, replacing the director position with a five-member commission.

If the Senate is out of town for four or more consecutive days, the president can make appointments that are not subject to confirmation by that chamber. With a series of procedural moves, Republicans prevented that from happening. Although no business was to be conducted during Memorial Day week, three "pro forma" sessions were scheduled for May 27, May 31 and June 3.

Democrats bashed the GOP move, with Rep. Barney Frank, D-Mass., the lead House writer of last year's reform bill, calling it "an outrageous abuse of the Constitution."

"They're saying, 'we don't like the law that was passed, so we'll abuse the Constitution to wreck the law,'" Frank said. "That's what they're trying to do."

On May 24, the animosity between Warren and congressional Republicans was clear as she clashed with GOP Rep. Patrick McHenry of North Carolina during a hearing of a subcommittee of the House Oversight and Government Reform Committee. At the end of an exchange that was already fairly heated, Warren insisted that she and the panel had an agreement that she would leave after testifying for an hour and said, "Congressman, you are causing problems." McHenry, responded, "You're making this up, Ms. Warren. This is not the case. This is not the case."

Warren might eventually end up being a congressional colleague. Massachusetts Democrats reportedly want her to run against Republican Sen. Scott Brown in 2012.

House Committee Votes to Revise Consumer Bureau

The House Financial Services Committee on May 13 voted largely along party lines to put the new Consumer Financial Protection Bureau (CFPB) under the control of a five-member commission and to make other changes to the agency.

The bureau, which was created by the 2010 financial regulations reform law to oversee mortgages, credit cards, student loans and other financial products, is, under current law, to be headed by a director once it is fully operational this summer.

The committee approved the "Responsible Consumer Financial Protection Regulations Act" (H.R. 1121) from committee Chairman Spencer Bachus, R-Ala., which would require the bureau to adopt the commission structure.

"Everyone on this committee supports robust consumer protection," Bachus said. "But there must be real oversight and accountability of every massive government bureaucracy, and that includes the CFPB."

Bachus is leading Republican efforts to alter or repeal the reform law.

The subcommittee also approved the "Bureau of Consumer Financial Protection Transfer Clarification Act" (H.R. 1667) from Rep. Shelley Moore Capito, R-W.V., which would require that a Senate-confirmed director be in place before the bureau officially becomes a regulatory agency, which is scheduled to happen on July 21. President Obama has not yet nominated a director for the bureau.

Finally, the panel approved the "Consumer Financial Protection Safety and Soundness Improvement Act" (H.R. 1315) from Rep. Sean Duffy, R-Wisc., which would clarify that the new Financial Stability Oversight Council must set aside any bureau regulation that is inconsistent with the safe and sound operation of U.S. financial institutions, and would allow the council to strike down a regulation with a simple majority of its 10 voting members. The law now allows the council to reject bureau rules only if two-thirds of its voting members decide that the regulation would imperil the safety and soundness of the country's entire financial system.

Democrats and consumer groups have criticized the proposals, saying they would weaken important consumer protections.

"Make no mistake, by expanding the ability for banking regulators to veto the CFPB, I believe that my Republican colleagues are far less concerned about the stability of the banking system and far more concerned about hurting bank profitability," Rep. Maxine Waters, D-Calif., said.

CBO Backs Fair-Value Approach to Calculating Public Pension Liabilities

The Congressional Budget Office concluded in a report released in May that the discount rates used by most public pension plans to calculate funding ratios may be as much as double what they should be, even as it noted that "there is no necessary connection between the information provided by [liability projections] and the determination of a sponsor's annual contributions to the plan."

Public pensions generally use a discount rate of 8 percent – which is based on the historical rate of return on investments and is in accordance with guidelines from the Governmental Accounting Standards Board (GASB) – but some critics say this is too high and argue that pension funds should use a rate that is not tied to the uncertain performance of the stock market.

The CBO report noted that projections using an 8 percent discount rate put unfunded liabilities for state and local pensions nationwide at $700 billion while more conservative calculations lead to a total shortfall of as much as $3 trillion.

The CBO endorsed the use of the fair-value approach in computing pension liabilities, which it defined as "what a private insurance company operating in a competitive market would charge to assume responsibility for those obligations." It dismissed the argument that an 8 percent return assumption is appropriate given pension plans' essentially infinite investment horizons by stating that "even over very long periods, higher returns on risky investments are not a sure thing." The fair-value approach – which would involve using a discount rate of 4-5 percent – better reflects investment risk, the CBO concluded.

"By accounting for the different risks associated with investment returns and benefit payments, the fair-value approach provides a more complete and transparent measure of the costs of pension obligations," the report stated.

Even so, the CBO cautioned that "adopting a fair-value approach in reporting pension plans' finances could indicate a need for a significant increase in funding, which would further strain government budgets – despite the fact that, on average, a much smaller increase in funding might turn out to be sufficient to cover pension plans' liabilities." The amount of annual contributions, then, could be based on other methods, such as the GASB standards, according to the CBO.

Either way, the agency cautioned against taking an alarmist approach to pension funding issues.

"Most state and local pension plans," the report stated, "probably will have sufficient assets, earnings, and contributions to pay scheduled benefits for a number of years and thus will not need to address their funding shortfalls immediately.

Lawmakers Seek to Stanch 401(k) Leakage

Two senators on May 18 proposed a bipartisan bill that aims to protect retirement savings in 401(k) accounts.

Early withdrawals and loans that are not paid back produce significant amounts of "leakage" from 401(k)s, leaving workers with less retirement income.

The "Savings Enhancement by Alleviating Leakage (SEAL) in 401(k) Savings Act of 2011" (S. 1020) from Sens. Herb Kohl, D-Wisc., and Mike Enzi, R-Wyo., would provide flexibility to loan repayment hardship tax rules and limit 401(k) loan practices. Specifically, it would:

- Give employees who roll over a 401(k) that has an outstanding loan into an IRA upon leaving an employer until the next year's tax filing to repay the amount remaining on the loan. (The amount now must be paid in full at the time of the rollover or the employee will default on the loan.)

- Allow employees to continue to make elective contributions during the six months immediately following a 401(k) hardship withdrawal. (Such contributions are now prohibited.

- Limit the number of 401(k) loans an employee can have open at one time to three. (There is no legal limit now, though plan sponsors may limit the number if they wish.)

- Ban products such as 401(k) debit cards that encourage leakage.

"As the frequency of retirement fund loans have gone up, the amount of money people are saving for their retirement has gone down," Kohl said. "While having access to a loan in an emergency is an important feature for many participants, a 401(k) savings account should not be used as a piggy bank."

Financial Crisis Report Shows Need for Reform, Democrats Argue

The report released in January on the nation's financial crisis demonstrates the need for the 2010 Dodd-Frank financial regulations reform law, a leading Senate Democrat said in May.

"We cannot allow Dodd-Frank to be dismantled," Senate Banking, Housing and Urban Affairs Committee Chairman Tim Johnson, D-S.D., said at his panel's May 12 hearing on the work of the Financial Crisis Inquiry Commission. "We simply cannot afford to go back to the old financial system that destroyed millions of jobs and cost the economy trillions of dollars."

The commission, which was chaired by former California Treasurer Phil Angelides, spent about a year holding hearings to try to determine what led to the bursting of the housing bubble, the collapse of major financial firms, an economic recession and other fiscal troubles. The final report – which was only endorsed by the six Democrats on the 10-member panel – cast blame in both the public and private sectors.

Republicans, especially in the House of Representatives, have been working to alter or repeal the reform bill, but Johnson said that this would be "dangerous and irresponsible."

Angelides told members of the Banking Committee that "the law's financial reforms are strong and needed, and that the law directly and forcefully addresses issues and conclusions identified in our report."

"In the wake of this crisis, it is critical that the Dodd-Frank law be fully implemented, with sufficient resources for proper oversight and enforcement, to help prevent a future crisis," he said. "It is important for regulators and prosecutors to vigorously investigate and pursue any violations of law that have occurred to ensure that justice is served and to deter future wrongdoing. And, it is essential that we focus our efforts anew on rebuilding an economy that provides good jobs for Americans and sustained value for our society – in place of an economy that, in the years before the crisis, was inordinately driven by financial engineering, risk and speculation."

Sen. Richard Shelby of Alabama, the committee's ranking Republican, however, dismissed the reform law as "a wish-list of reforms long sought by liberal activists, special interests and federal bureaucrats."

HHS Issues Final Rule on Health Insurance Premium Reviews

The Department of Health and Human Services (HHS) on May 19 released the final regulation to require that large increases in health insurance premiums be reviewed by state or federal officials.

The rule will require that, as of September 1, proposed premium increases of more than 10 percent in most individual and small group health insurance plans be reviewed.

"Effective rate review works," HHS Secretary Kathleen Sebelius said. "It does so by protecting consumers from unreasonable rate increases and bringing needed transparency to the marketplace. During the past year, we have worked closely with states to strengthen their ability to review, revise or reject unreasonable rate hikes. This final rule helps build on that partnership to protect consumers."

In September 2012, the 10 percent threshold will be replaced by state-specific numbers.

The rule also requires insurance companies to provide consumers with information about the reasons for rate increases that exceed the review threshold and to post the justifications for the hikes on their websites as well as on HHS's health care reform website**,** www.healthcare.gov.

The 2010 health care reform law provided $250 million in grant money to help states improve their oversight of rate increases.

Proposal Would Require Review of Economic Impact of Certain EPA Rules

Lawmakers on May 4 introduced legislation that would require a new committee to examine the economic impact of certain rules issued by the Environmental Protection Agency (EPA).

The "Transparency in Regulatory Analysis of Impacts on the Nation (TRAIN) Act of 2011," (H.R. 1705) which was introduced by Rep. John Sullivan, R-Okla., and Rep. Jim Matheson, D-Utah, would create the interagency Committee for the

Cumulative Analysis of Regulations that Impact Energy and Manufacturing in the United States to review certain EPA regulations. The proposal, in part, targets the EPA's efforts to implement regulations aimed at slowing climate change.

"The truth is the EPA has no idea how much all of this regulation is costing our economy, because it has failed to conduct a study of the overall, cumulative cost of their regulatory agenda," Sullivan said "We desperately need an honest accounting of how much the EPA's regulatory train wreck is costing our economy and American consumers, which is exactly what the bipartisan TRAIN Act will accomplish."

The House of Representatives in April voted to strip the EPA of its authority to regulate greenhouse gases to counter climate change.

RELATED NATIONAL AND INDUSTRY NEWS

NIRS Study Dismisses Public Pension Asset Exhaustion as 'Remote Possibility'

The exhaustion of public pension assets is only a "remote possibility," according to a study released by the National Institute on Retirement Security (NIRS).

Critics of state and local pensions, such as Northwestern University Professor Joshua Rauh, argue that the funds face as much as $3 trillion in combined shortfalls, that several could fold within the next few decades and that some will probably seek a federal bailout. Some lawmakers have pointed to these findings to support efforts to impose changes on public retirement systems. A proposal from Rep. Devin Nunes, R-Calif., for example, would require public pensions to disclose their funding status by using a "risk-free" rate of investment return – as would be expected from U.S. Treasury bonds – rather than the rate that stock investments have historically returned. This would greatly increase shortfall projections, which could lead to a move away from defined benefit pensions and toward defined contribution accounts.

The NIRS report, though, found that "plans have on average 30 years of breathing room."

"Due to the long-term nature of their liabilities, state and local governments can adjust to changes in financial and economic conditions," the report stated. "Moreover, public pension[s] are quickly recovering from [the] financial downturn and could emerge even stronger thanks to a myriad of recently enacted legislative changes."

The report noted that no public fund has sought a bailout and asserted that pension fund adjustments are best handled on a state-by-state basis, rather than with a federal mandate. It derided asset exhaustion projections by Rauh and others as representing "a flawed, simplified way to view the sustainability of these pension plans."

"With some limited exceptions," the study concluded, "states and localities do not face an immediate pension shortfall that would require sponsors to pay benefits from operating revenues even under dire termination assumptions."

NASRA Official Criticizes Public Pension Proposal

A NASRA official blasted proposed legislation related to public pensions in an appearance at the National Federation of Municipal Analysts conference in May.

Keith Brainard, research director of the National Association of State Retirement Administrators (NASRA), said that "nothing good can come from" the "Public Employee Pension Transparency Act" (H.R. 567) from Rep. Devin Nunes, R-Calif. The bill would require state and local pension funds to disclose their liabilities as calculated using a "risk-free" rate of return – essentially what would be provided by U.S. Treasury bonds, about 4 percent, instead of the historical rate of about double that that is used by most plans – and would prohibit federal bailouts of public pensions.

"To my knowledge, no public pension plan has asked for federal assistance and hopefully none will," Brainard said.

Brainard said that claims of a public pension crisis are exaggerated and that there is "nothing magical" about a particular level of funding, whether 100 percent or 80 percent or any other number.

"It really is a matter of degree, not kind," he said. "You can be 100 percent funded and still have fiscal problems."

In assuming a rate of investment return that matches historical trends to calculate funding ratios, public pensions are following the method recommended by the Governmental Accounting Standards Board. Critics say this does not account for the uncertainties of the stock market and forces taxpayers to assume too much investment risk, but Brainard defended the current approach.

"We would like GASB to continue to be the auditor of how pension liabilities are calculated," he said. "We view federal intervention as an effort to make an end-run around GASB."

Limited Ban on Direct-to-Consumer Ads Could Have 'Little Effect' on Drug Prices, CBO Finds

Prohibiting pharmaceutical companies from using direct-to-consumer (DTC) advertising to promote new drugs "could have little effect on the prices of some drugs subject to the ban," the Congressional Budget Office (CBO) concluded in a report released on May 26.

Drug makers in 2008 spent $4.7 billion on DTC advertising, nearly one-fourth of the total amount they spent on marketing. Critics say that DTC advertising can encourage the use of drugs that are not necessarily best for the patient, increase overall drug spending and, in the case of new drugs, lead consumers to use medicines whose effects might not be fully known, even after they have been vetted by the Food and Drug Administration (FDA). As a result, some have proposed banning such advertising during the two years following FDA approval.

The CBO found that, while a two-year ban might decrease demand – and, thus, prices – for certain drugs, pharmaceutical companies would probably mitigate the potential reduction in demand by using the funds they would have spent on DTC advertising for other promotional activities. The agency also noted that consumer demand for a given drug is often largely shaped by insurance coverage or non-coverage of the drug.

"As a result, individuals' demand for certain drugs can depend as much on insurers' actions as on drug makers' promotional activities, including DTC advertising," the CBO noted.

The CBO found that a two-year ban could have some positive effects on public health, since "researchers have found a link between the promotional activities that pharmaceutical manufacturers use to expand the market for their drugs and increased reporting to the FDA of adverse events from a greater number of people taking those drugs." It also concluded, though, that there could be some negative impacts, as well.

"Positive effects on health from DTC advertising could be lost or delayed," according to the agency. "Some studies have found that DTC advertising spurs individuals to seek treatment when they otherwise might not and improves patients' compliance with prescribed drug regimens. Therefore, for drugs whose health benefits outweigh their safety and other concerns, a moratorium might reduce their use by a portion of the population who would benefit from the drugs."

California Congressional Delegation News

House Panel Reviews Public Pension Disclosures Bill

Republican and Democratic lawmakers resumed their debate over public pensions in May.

GOP congressmen in the Republican-controlled House of Representatives have held several hearings this year to examine the funding and transparency of state and local pension plans. Republicans generally argue that the unfunded liabilities of public pensions are as much as five times higher than is claimed by the plans and that major reforms are needed, while Democrats, as a rule, say that pension funding is not a major problem and the GOP is unfairly targeting public workers. Those themes were played out again at a May 5 hearing of the House Ways and Means Committee's Oversight Subcommittee.

"Public sector pensions encourage state and local governments to overpromise, underfund and take on risky investments by discounting guaranteed future benefits against unrealistic rates of return," subcommittee Chairman Charles Boustany, R-La., said.

The panel's ranking Democrat, Rep. John Lewis of Georgia, meanwhile, charged that Republicans were trying to "paint teachers, firefighters, librarians and nurses as villains in their quest to widen the gap between the rich and the poor."

Several Republicans expressed support for the "Public Employee Pension Transparency Act" (H.R. 567) from Rep. Devin Nunes, R-Calif., which would require state and local pension funds to disclose their liabilities as calculated using a "risk-free" rate of return – essentially what would be provided by U.S. Treasury bonds, about 4 percent, instead of the historical rate of about double that that is used by most plans – and would prohibit federal bailouts of public pensions. (The Oversight Subcommittee does not have jurisdiction over the bill.) Rep. Xavier Becerra, D-Calif., and other Democrats, though, said that the legislation is designed to end public sector defined benefit plans and rejected claims by bill supporters that it is intended to protect state and local employees.

The four witnesses invited by the GOP majority also backed the Nunes bill, with Colorado Treasurer Walker Stapleton, a trustee of the Public Employees' Retirement Association (PERA) of Colorado, saying the transparency that the bill would provide is needed because PERA "is operating with an unrealistic and unachievable rate of return, which is now set at 8 percent."

"The question is whether states like Colorado should be in the business of guaranteeing market returns," Stapleton said. "If the answer to this question is 'no,' as I believe it should be, then public pension plans like PERA need to start adopting rates of return in line with Treasury yields and stop the pervasive underfunding of plans. Overestimating a pension system's expected return is essentially gambling with the financial welfare of the next generation of Americans."

Josh Barrow of the Manhattan Institute for Policy Research, similarly said that the discount rates used by plans are "unreasonably high" and do not provide an accurate picture of their financial health.

"Such rates allow them to understate their true liabilities and claim to be better funded than they really are," Barro said. "Plans should additionally report their liabilities discounted at a lower rate that corresponds to the low risk borne by pensioners that they won't be paid. Doing this would result in plans' reporting a higher – and more accurate – present-value liability and a lower ratio of assets to liabilities."

Nunes' proposal, Jeremy Gold of Jeremy Gold Pensions said, would provide "very valuable disclosures" that "will make the funding status of public plans clear, economically realistic and comparable across jurisdictions."

"Until now, the agents responsible for plan management have been making important financial decisions – benefit levels, funding and investment strategies – without the information necessary to determine, one, the value of benefits as a component of total compensation; two, the efficacy of funding and investment strategies; three, which generation of taxpayers are paying for services rendered; and four, how plans in one jurisdiction compare to those in other jurisdictions."

Robert Kurtter of Moody's Investors Service, meanwhile, said that Nunes' legislation would increase access to public plan information and improve the quality of reporting.

The one witness invited by Democrats, Iris Lav of the Center on Budget and Policy Priorities, defended the "modest" pension benefits received by most public employees, said that public pension funding challenges have been overstated and called the Nunes bill "a solution in search of a problem." The Governmental Accounting Standards Board is working to increase the financial transparency of public pensions, she said, and the legislation could short-circuit that process by forcing the use of an inexpertly-devised approach. In addition, she added, the bill could produce "any of several deleterious effects."

"States could end up cutting education or other priority investments in order to free up room in their budgets for pension contribution levels that exceed the amounts needed to cover future pension liabilities," Lav said. "Or states could raise taxes more than is needed. Moreover, the overfunding of pension plans that ultimately would result could lead to demands for increased pension benefits that would not represent a sound use of resources."

Lav also echoed the charge by some Democratic lawmakers that many of the critics of public pensions – and supporters of the Nunes bill – are at least in part motivated by a desire to get states and localities to drop defined benefit pensions and, instead, provide employees with defined contribution accounts. But such accounts, she said, would not improve pension funds' finances, and the approach represents "a more expensive way to provide a given level of retirement income to employees because it lacks the benefits of improved investment returns that result from a pension trust fund's pooled investments, professional money managers and shared administrative costs."